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*Mark
Seymour*



America's leading family-priced steakhouse chain, Ponderosa System, Inc. includes 462 Company-operated and 236 licensee-operated steakhouses in 29 states and 9 Canadian provinces. Total System revenues were \$487,128,000 in fiscal 1981. Total corporate revenues were \$334,048,000. ESI Meats, Inc., a wholly-owned subsidiary, operates two portion control and freezer plants. ESI supplies beef and other items to all Company steakhouses, plus licensees and independent customers. Ponderosa has approximately 22,000 full or part-time employees.

Ponderosa Steakhouses have great appeal to all chain restaurant patrons, offering customers outstanding value through quality food, friendly service and reasonable prices. Nearly 128 million meals were served throughout the System in fiscal 1981... over 87 million in Company-operated steakhouses.



contents

Corporate Profile	1
Fiscal 1981 Highlights	2
Letter to Shareholders	3-4
Financial Highlights	5
The Ponderosa Perspective	6-10
Ten Year Financial Data	12-13
Quarterly Financial Data and Common Stock Information	14

Management's Discussion of Financial Condition and Results of Operations	15-19
Financial Reporting and Code of Business Conduct	20
Index to the Consolidated Financial Statements and Notes	21
Report of Independent Accountants	21
Locations	40
Corporate Information	41
Directors and Officers	42



Fiscal 1981 Highlights

- Leadership position maintained
- Market share increased
- ESI Bristol facility opened
- Strategic management system installed
- Food, labor and energy cost-control systems refined
- Over 1300 graduates from Ponderosa Development Institute
- Company restructured into three strategic business units
- International expansion planned

While Ponderosa's revenues for fiscal year 1981 increased 2% over the previous year to a record \$334,048,000, earnings decreased to \$2,568,000 from \$13,496,000. The earnings decline was primarily attributable to the impact of the economic recession in Ponderosa's heartland trading areas, where unemployment averaged 31% above the balance of the nation.

Despite the earnings decline, a great deal was accomplished through the year and we are encouraged about the trend of business activity and other developments which I would like to share with you.

To begin with, our earnings were impacted by a pretax write-off of \$3,700,000 or 38 cents per share after tax for nonrecurring charges associated with discontinued capital projects and a

one-time charge reducing future overhead expenses. These reductions, which totaled \$1,700,000 on an annualized basis, will benefit our operating performance this coming year.

Customer traffic, while down 1% for the year, showed a positive trend, recovering from a negative comparison of 16% versus a year ago in the first quarter to a 19% favorable comparison in the fourth quarter. This customer growth reinforced our leadership position in the budget steak segment of our industry. According to the most recent outside marketing data available, Ponderosa's market share increased from 22.9% last year to 29.3% currently.

It should be recognized that our customer count trends have held up much better in this recession than during the recession in fiscal years 1975-76. We believe this reflects the actions taken to improve the quality

and broaden the appeal of the Ponderosa Steakhouse concept.

Other financial areas are to be noted. Food costs were down slightly versus the prior year despite double-digit inflation and increased promotion activity. This was accomplished even as we improved food quality and introduced a children's menu and a lunch program to broaden our customer base. In addition, our long-term debt was reduced by \$9,752,000 from figures reported in August. Capital expenditures were reduced from a planned \$52,000,000 to \$20,000,000 in response to the worsening economy, demonstrating our ability to adjust plans promptly. Our capital spending supported the opening of a new meat plant and the renovation of 22 units, which will strengthen our business in future years. We also opened 21 company units, while closing 9 marginal locations.

During the year, Ponderosa successfully defended itself against an unfriendly takeover attempt by purchasing 430,600 shares of its common stock. While

Senior Corporate Management, clockwise from center: Gerald S. Office, Jr., Chairman of the Board and President; Michael K. Pulliam, President - ESI Meats, Inc.; William R. Menzel, Vice President (Corporate Planning and Development); Philip J. Dambach, Executive Vice President (International Development); C. S. Lewis, Executive Vice President (North America Steakhouse Operations); Donald R. Jackson, Executive Vice President (Finance); John W. Cleveland, Executive Vice President (Administration).

some related legal and interest expenses were incurred in the near term, your company's long range posture was strengthened by this reiteration of our belief that Ponderosa shareholder interests are best served by remaining an independent company.

There were other significant developments. A strategic management system was installed with the assistance of A.D. Little, Inc. This system guided the formulation of long-term objectives and strategies. The objectives are designed to achieve our basic purpose of enhancing the value of your investment in Ponderosa over the long-term. Our objectives are to:

- Achieve an attractive level of earnings with improved consistency
- Improve the profit margin of the corporation
- Achieve an attractive return on capital employment.

Supporting these objectives are well-defined strategies, which, in turn, are supported by operating plans. The objectives, strategies, and plans encompass a 6-year time-frame to include a complete business cycle.

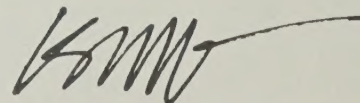
The strategic management system also involves the allocation of resources to the investment alternatives most likely to achieve our objectives.

To support our strategic management system, the corporation was reorganized into three strategy centers and three corporate staff divisions. The strategy centers are North America Steakhouse Operations, International Development, and ESI Meats. We believe that significant growth potential exists in each of these areas. The staff divisions are Finance, Administration, and Corporate Planning and Development.

We will seek to reduce the cyclicity of our current business through increased domestic licensing, increased outside sales at ESI, and licensing the steakhouse concept on an international basis. Long-term, we will consider entry in new businesses that are consistent with our skills. We are confident that we have the competence to manage these areas very effectively.

While the outlook for the economy has not significantly improved, the outlook for Ponderosa has. Our cautious optimism stems from leveling meat costs, the marketing knowledge we have gained this past year, an improved organization structure, and the implementation of our strategic management system. We will also maintain strict control of capital spending, administrative expenses and inventories to strengthen our balance sheet, and thereby support future growth.

While the past year was difficult, and we are not satisfied with the results, we feel that in the context of the economic conditions much credit must be given to our employees and licensees for their efforts. Their performance is best illustrated by the steady gains in market share Ponderosa achieved during the year. The changes we have made are targeted to maximizing the value of your investment. We appreciate your continued support and encouragement.



Gerald S. Office, Jr.
Chairman of the Board and President
May 4, 1981

Financial Highlights

	February 26, 1981	February 28, 1980	February 22, 1979
Total System Revenues	\$487,128,000	\$481,503,000	\$406,898,000
Total Corporate Revenues	\$334,048,000	\$328,423,000	\$273,907,000
Net Income	\$ 2,568,000	\$ 13,496,000	\$ 13,798,000
Net Income Per Share	\$ 0.60	\$ 2.94	\$ 3.02
Total Assets	\$205,084,000	\$212,205,000	\$181,653,000
Stockholders' Equity	\$ 64,780,000	\$ 69,309,000	\$ 57,332,000
Net Income as a % of Revenues	0.8%	4.1%	5.0%
Return on Average Stockholders' Equity	3.8%	21.3%	27.0%
Dividends Declared Per Share	\$ 0.40	\$ 0.40	\$ 0.325

Revenues

(Millions)

Fiscal Year	
1981	\$334.0
1980	\$328.4
1979	\$273.9
1978	\$196.5
1977	\$163.5
1976	\$149.0
1975	\$129.7
1974	\$114.8
1973	\$73.5
1972	\$46.5

Earnings

(Per Share)

Fiscal Year	
1981	\$0.60
1980	\$2.94
1979	\$3.02
1978	\$2.00
1977	\$0.56
1976	\$0.30
1975	\$0.36
1974	\$2.04
1973	\$1.33
1972	\$0.84

Steakhouses

(Company Operated & Licensee Operated)

Fiscal Year	Company	Licensee	Total
1981	462	236	698
1980	450	231	681
1979	426	210	636
1978	384	204	588
1977	342	219	561
1976	322	209	531
1975	300	203	503
1974	226	163	389
1973	148	96	244
1972	77	76	153

Our Concept: The Ponderosa Steakhouse menu features steak, prime rib and seafood entrees, and an all-you-can-eat salad bar. Each steakhouse seats about 200 customers in a comfortable, contemporary setting, and is open seven days a week for lunch and dinner. Service is waitress-assisted, with no tipping.

All company steakhouse interiors now reflect the warmth of our new interior design, including more dining privacy.



The Ponderosa Concept 80 steakhouse features a cedar exterior with front of natural wood and stone. The interior also features natural wood, plus an attractive variety of plants, all enclosed by a cathedral ceiling. Energy-saving construction and efficient use of interior space make the building as functional as it is attractive.



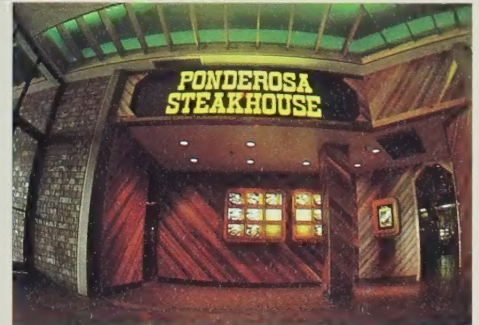
Our traditional free-standing steakhouses contain 5,400 square feet of interior space, and include parking for 100 cars.



An exterior design package has been developed to transform our traditional steakhouse exteriors to our new contemporary look.

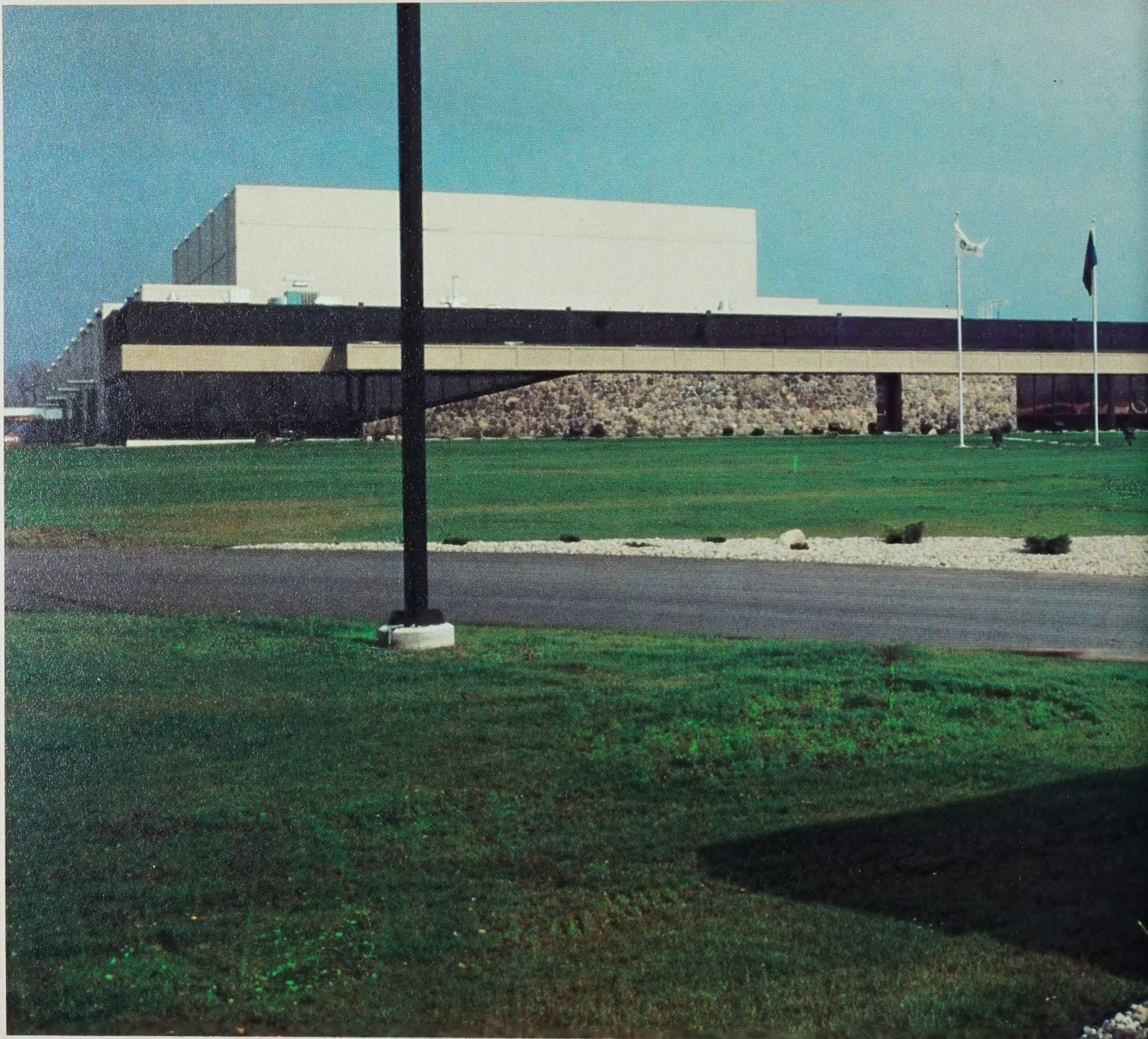


The new Ponderosa exterior design has also been adapted to steakhouses located inside regional shopping malls.



Standing 65 feet high, and covering 150,000 square feet, the ESI plant in Bristol, Indiana is one of the world's largest portion control and freezer facilities under one roof. The facility contains a full complement of restaurant equipment to test new products, as well as a complete food laboratory.

ESI's strengths are its meat purchasing knowledge, portion control production systems, freezer storage capacity and national distribution network.



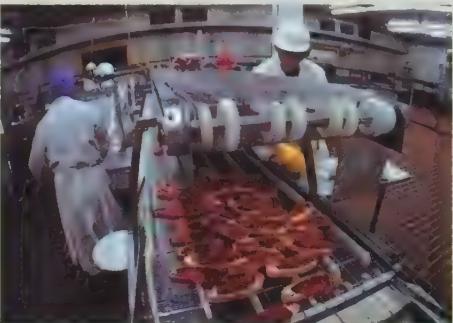
Total ESI portion control capability is now 2,000,000 pounds of meat per week, with freezer capacity of 16,000,000 pounds.



A growing number of third parties now purchase meat and other products from ESI.



Consistent quality control is achieved utilizing modern technology.



Quality food, at reasonable family prices, remains the core of the Ponderosa concept. Food purchasing specifications are constantly reviewed to ensure system-wide consistency.

Ponderosa's all-you-can-eat salad bar features a wide variety of fresh items, attractively displayed.



Ten Year Financial Data

Year Ended (In thousands except per share data)	Feb. 26, 1981	Feb. 28, 1980**	Feb. 22, 1979	Feb. 23, 1978*
REVENUES				
Food sales	\$329,551	\$322,744	\$268,522	\$191,708
Service fees and other income	4,497	5,679	5,385	4,840
TOTAL REVENUES	334,048	328,423	273,907	196,548
COST AND EXPENSES				
Cost of food sales	145,805	143,207	113,309	81,771
Restaurant operating expenses	151,270	134,787	113,849	81,300
Rent expense	11,031	8,417	6,522	5,333
General and administrative expenses	14,017	11,299	8,197	5,712
Interest expense and other	9,898	8,292	8,485	6,727
Deferred advertising and training write-off	—	—	—	—
TOTAL COST AND EXPENSES	332,021	306,002	250,362	180,843
INCOME BEFORE INCOME TAXES	2,027	22,421	23,545	15,705
TOTAL INCOME TAXES	(541)	8,925	9,747	6,747
NET INCOME	\$ 2,568	\$ 13,496	\$ 13,798	\$ 8,958
Net Income Per Share	\$ 0.60	\$ 2.94	\$ 3.02	\$ 2.00
Total Assets	\$205,084	\$212,205	\$181,653	\$137,325
Long-term Obligations	\$ 93,590	\$ 93,925	\$ 83,161	\$ 65,707
Stockholders' Equity	\$ 64,780	\$ 69,309	\$ 57,332	\$ 44,866
Dividends Declared Per Share	\$ 0.40	\$ 0.40	\$ 0.325	\$ 0.075
Book Value Per Share	\$ 15.05	\$ 15.10	\$ 12.54	\$ 10.00
Property, Plant and Equipment Additions	\$ 19,970	\$ 47,221	\$ 35,977	\$ 12,078
Return on Average Stockholders' Equity	3.8%	21.3%	27.0%	22.3%

*Restated to reflect the adoption of FAS No. 13, Accounting for Leases.

**Comprised of 53 weeks.

Revenues

(Millions)

Fiscal Year	
1981	\$334.0
1980	\$328.4
1979	\$273.9
1978	\$196.5
1977	\$163.5
1976	\$149.0
1975	\$129.7
1974	\$114.8
1973	\$73.5
1972	\$46.5

Earnings

(Per Share)

Fiscal Year	
1981	\$0.60
1980	\$2.94
1979	\$3.02
1978	\$2.00
1977	\$0.56
1976	\$0.30
1975	\$0.36
1974	\$2.04
1973	\$1.33
1972	\$0.84

Debt/Equity Ratio

Fiscal Year

1981	1.44
1980	1.36
1979	1.45
1978	1.46
1977	1.68
1976	1.86
1975	1.80
1974	1.51
1973	1.15
1972	1.07

Feb. 24, 1977*	Feb. 26, 1976*	Feb. 27, 1975*	Feb. 28, 1974**	Feb. 23, 1973*	Feb. 25, 1972*
\$159,470	\$145,299	\$126,274	\$110,787	\$ 69,793	\$ 43,908
4,024	3,738	3,455	3,967	3,745	2,604
163,494	149,037	129,729	114,754	73,538	46,512
74,315	68,210	66,132	56,831	35,244	22,612
67,308	57,615	45,632	31,690	21,138	12,567
4,940	4,656	3,882	2,746	1,615	996
6,152	6,126	5,370	3,729	2,585	1,936
6,982	6,653	6,256	3,292	2,237	1,789
—	3,550	—	—	—	—
159,697	146,810	127,272	98,288	62,819	39,900
3,797	2,227	2,457	16,466	10,719	6,612
1,275	870	829	7,379	4,910	3,148
\$ 2,522	\$ 1,357	\$ 1,628	\$ 9,087	\$ 5,809	\$ 3,464
\$ 0.56	\$ 0.30	\$ 0.36	\$ 2.04	\$ 1.33	\$ 0.84
\$110,831	\$110,503	\$104,756	\$ 92,664	\$ 54,620	\$ 34,228
\$ 59,561	\$ 61,505	\$ 57,030	\$ 45,077	\$ 23,286	\$ 14,894
\$ 35,519	\$ 32,997	\$ 31,641	\$ 29,874	\$ 20,194	\$ 13,975
—	—	—	—	—	—
\$ 7.94	\$ 7.37	\$ 7.07	\$ 6.71	\$ 4.63	\$ 3.40
\$ 15,456	\$ 11,986	\$ 25,691	\$ 26,620	\$ 13,431	\$ 6,763
7.4%	4.2%	5.3%	36.3%	34.0%	39.3%

Book Value (Per Share)

Fiscal Year	
1981	\$15.05
1980	\$15.10
1979	\$12.54
1978	\$10.00
1977	\$ 7.94
1976	\$ 7.37
1975	\$ 7.07
1974	\$ 6.71
1973	\$ 4.63
1972	\$ 3.40

Return on Equity

Fiscal Year	
1981	3.8%
1980	21.3%
1979	27.0%
1978	22.3%
1977	7.4%
1976	4.2%
1975	5.3%
1974	36.3%
1973	34.0%
1972	39.3%

Capital Spending (Millions)

Fiscal Year	
1981	\$20.0
1980	\$47.2
1979	\$36.0
1978	\$12.1
1977	\$15.5
1976	\$12.0
1975	\$25.7
1974	\$26.6
1973	\$13.4
1972	\$6.8

**Quarterly
Financial Data
and Common Stock
Information**

The following is a table of financial data by quarter for the past two years (Unaudited):

Fiscal 1981	Quarter Ending			
	(In thousands except per share data)			
	May 22, 1980	Aug. 14, 1980	Nov. 6, 1980	Feb. 26, 1981**
Revenues	\$75,649	\$79,101	\$77,194	\$102,104
Operating Profit*	\$ 5,644	\$ 5,186	\$ 5,462	\$ 5,153
Net Income	\$ 1,510	\$ 1,061	\$ 1,145	\$ (1,148)
Net Income Per Share	\$ 0.33	\$ 0.25	\$ 0.27	\$ (0.25)

*Operating profit is total food sales less cost of food sales, restaurant operating expenses and rent expense.

**Fourth quarter (16 weeks) net income was decreased by \$1,200,000, or \$0.28 per share, resulting from a charge for unusual or nonrecurring charges associated with write-offs of discontinued capital projects and one-time charges reducing future overhead expenses.

Fiscal 1980**	Quarter Ending			
	(In thousands except per share data)			
	May 17, 1979	Aug. 9, 1979	Nov. 1, 1979	Feb. 28, 1980 ***
Revenues	\$78,898	\$79,976	\$75,507	\$94,042
Operating Profit*	\$11,210	\$11,007	\$ 8,143	\$ 5,973
Net Income	\$ 4,673	\$ 4,730	\$ 3,211	\$ 882
Net Income Per Share	\$ 1.02	\$ 1.03	\$ 0.70	\$ 0.19

*Operating profit is total food sales less cost of food sales, restaurant operating expenses and rent expense.

**Comprised of 53 weeks. Fourth quarter is comprised of 17 weeks.

***Fourth quarter 1980 net income was increased by \$914,000, or \$0.20 per share, resulting from changes in certain leases as more fully set forth in Note B and decreased by \$830,000, or \$0.18 per share due to an increase in the Company's full year effective tax rate. The latter change was due to an increase in the estimated accrual rate for income taxes from that used in prior quarters.

The high and low stock prices and dividend information for the past two years for the Company's common stock as reported on The New York Stock Exchange composite tape are shown below:

Composite Closing Price Ranges*

Fiscal 1981	High	Low	Dividend	Fiscal 1980	High	Low	Dividend
1st Quarter	\$13	\$ 9¾	\$0.10	1st Quarter	\$19⅞	\$16⅞	\$0.10
2nd Quarter	\$15	\$11⅞	\$0.10	2nd Quarter	\$18⅞	\$15	\$0.10
3rd Quarter	\$12¾	\$10⅞	\$0.10	3rd Quarter	\$23	\$14⅞	\$0.10
4th Quarter	\$12	\$ 9⅞	\$0.10**	4th Quarter	\$15⅞	\$11	\$0.10

*The Company's common stock is traded on The New York, Midwest, Philadelphia and Boston Stock Exchanges. The symbol of Ponderosa System, Inc. is PON. The number of stockholders, of record, as of May 4, 1981 was 4,492.

**Declared after the end of the fiscal year for the fourth quarter of fiscal 1981.

Ponderosa System, Inc. financed its growth during the past decade principally from the profits from operations and landlord financing utilizing build-to-suit steakhouse leases. More recently, substantial investment in remodeling of existing steakhouses, all of which has been completed, construction of new steakhouses and the construction of the new ESI portion control and freezer facility have been financed by long-term, fixed rate, privately placed notes. Since November of 1978, the Company has borrowed \$40,300,000 on this basis of which \$31,000,000 is unsecured and \$9,300,000 is secured by a first mortgage on the ESI Bristol, Indiana facility. To a more limited extent, the Company has financed certain steakhouses with mortgages and Industrial Revenue Bonds.

Indicative of the Company's physical growth, Ponderosa made additions to property, plant and equipment of \$20,000,000 in fiscal 1981 following expenditures of \$47,200,000 in fiscal 1980 and \$36,000,000 in fiscal 1979. The lower level of additions to property, plant and equipment in fiscal 1981 was the result of planned reductions in capital expenditures brought about by the Company's decision to reduce its new steakhouse development plans. This action was predicated by the level of profitability of the Company as the result of the current economic conditions in its heartland states market area, the high cost of funds and the decrease in competitive new unit development.

The Company decided to concentrate its efforts on improving its debt-to-equity ratio that had increased to higher than planned levels. This increase followed a purchase of 430,600 of its common shares for \$7,300,000 including \$1,300,000 for an agreement on the part of the seller not to purchase any common shares of the

Company for ten years. The funds used in purchase of the Company's stock were borrowed under the terms of a \$20,000,000 revolving credit agreement that the Company maintained for a number of years but did not utilize. The terms and conditions of the Company's private placement and revolving credit agreements were renegotiated to accommodate the common stock purchase.

During fiscal 1981, the Company's debt-to-equity ratio increased from 1.36 to 1 to 1.44. Long-term debt and capitalized leases were reduced by \$9,752,000 from August 14, 1980, the end of the second fiscal quarter, to the end of the fiscal year. The Company plans to further reduce the ratio to 1 to 1 by limitation of its capital expenditures, repayment of debt and the replacement of capital leases with new operating leases. The latter results from the Company entering into new leases, at reasonable rentals with its landlords, in exchange for additional lease renewal option terms of five years each and the change of other business terms.

At the end of the fiscal year, the Company's current ratio was 0.81 to 1 in line with its cash management plan. A high velocity of cash caused principally by rapid inventory turn-over provides ample funds to meet current obligations.

It can be expected that the investments required to enable the business to grow, particularly if aggravated by double-digit inflation and the current high cost of borrowing, will continue to bring pressure on profit margins. Menu enhancements, continuing emphasis on productivity improvements, cost controls and selective price adjustments can be expected to mitigate some of the effects of inflation. However, the Company intends to continue to seek adequate financial returns commensurate with the risk and with the need to fund the growth of the business.

Management's
Discussion of
Financial Condition
and Results of
Operations (Continued)

Liquidity and
Capital Resources
(Continued)

The Company's future capital use funding strategy is based upon debt reduction to strengthen its capital structure to a relatively lower debt ratio and a strong balance sheet position to

enable management to consider a full range of financing options, both in the U.S. and abroad. Supplemental information regarding inflation is presented in Note K to the Consolidated Financial Statements.

Analysis of
Results of
Operations
Fiscal 1981
Compared to
Fiscal 1980

Total revenues increased by \$5,625,000 or 1.7% to \$334,048,000 in fiscal 1981. The revenue increase was 3.7% when adjusted for fiscal 1981 which contained 52 weeks as compared to 53 weeks in fiscal 1980. The increase in revenue was due to a \$6,807,000 or 2.1% increase in food sales offset by a \$1,182,000 or 20.8% decrease in non-food revenues. The increase in food revenues was primarily attributable to a higher number of restaurants open during the year. Annual per unit food revenues for units open the entire fiscal year were \$676,000 which is a 3.3% decrease from the prior year total of \$699,000. The latter decrease was the result of a planned marketing effort to promote the lower priced entrees in the Company's menu which reduced the average check. This strategy resulted in customer traffic gaining strength throughout the fiscal year. While customer traffic on an average weekly unit basis decreased 0.9% compared to the prior year, a 19.4% increase was experienced in the fourth quarter.

Service fees and other income decreased \$1,182,000. The change was attributable to a \$788,000 write-off of preconstruction expenditures, decreases in investment income of \$271,000 and fixed asset disposals of \$258,000 offset by increases in licensing revenues of \$24,000 and other of \$111,000.

Net income decreased \$10,928,000 or 81.0%. Net income as a percent of revenues decreased from 4.1% to 0.8%. Net income per share declined to \$0.60 or 79.6% as compared to \$2.94 per share in the prior year. In addition, fiscal 1981 absorbed \$1,617,000 or \$0.38 per share in after tax write-offs of unusual or nonrecurring charges associated with discontinued capital projects and one-time charges reducing future overhead expenses. In contrast, fiscal 1980 included a \$0.05 per share income for similar items.

Cost of food sales increased \$2,598,000 or 1.8% to \$145,805,000. However, as a percent of food sales, cost of food sales decreased to 44.2% as compared to 44.4% in the prior year. Inflationary increases in non-meat food products were offset by improved management controls and decreases in meat costs, especially in the latter half of the fiscal year.

Management's
Discussion of
Financial Condition
and Results of
Operations (Continued)

Restaurant operating expenses increased \$16,483,000 or 12.2% and as a percent of food sales increased to 45.9% from 41.8% in the prior year. The percentage increase of 12.2% was attributable to a 5.3% increase in average number of units open and a 6.9% increase in operating expenses. Labor accounted for 5.4% of the total increase of 12.2% and was due to the increase in the minimum wage from \$2.90 on January 1, 1979 to \$3.10 on January 1, 1980 and \$3.35 on January 1, 1981 and higher employee benefit costs. Advertising accounted for 1.6% of the increase and as a percent of food sales increased to 4.3% from 3.7%. Increases in utilities, depreciation, insurance and other expenses accounted for the remaining 5.2%.

Rent expense increased \$2,614,000 or 31.1% to \$11,031,000. This increase was due to a \$1,182,000 increase in the number of Company-operated steakhouses and a \$1,432,000 increase as a result of the accounting for certain leases as operating leases that were previously treated as capital leases. The Company has for the last two years been on a program to enter

into new leases with certain of its landlords to gain additional rights to possession by way of additional renewal options and to change other business terms in exchange for increases in rent. These new leases result in monthly payments being charged to rent expense that were previously charged to interest and depreciation.

General and administrative expenses increased \$2,718,000 or 24.1%. The total increase resulted primarily from a \$2,300,000 increase in employee costs and a \$375,000 increase from legal and other fees associated with litigation that resulted in a settlement and purchase of 430,600 shares of the Company's common stock.

Interest expense and other increased \$1,606,000 or 19.4%. The components of the change are the result of several offsetting factors and are fully described in Note B to the Consolidated Financial Statements.

Total income taxes resulted in a tax benefit of \$541,000 compared to a tax expense of \$8,925,000 in the prior year primarily the result of a decrease in pretax income of \$20,394,000 or 91.0%.

Analysis of
Results of
Operations
Fiscal 1981
Compared to
Fiscal 1980
(Continued)

Management's
Discussion of
Financial Condition
and Results of
Operations (Continued)

Fiscal 1980
Compared to
Fiscal 1979

Total revenues increased by \$54,516,000 or 20% to \$328,423,000 in fiscal 1980 due to increase in food sales from existing base units and the opening of new units. Average annual per unit food sales increased \$59,000 or 9% which is attributable to a significant increase in average check, product mix improvement, offset by a 10% decline in customer count. A portion of the revenue increase was due to the 53 week year in fiscal 1980 as opposed to a 52 week year in fiscal 1979.

Service fees and other income increased \$294,000 or 5%. Licensee service fees and other fees increased \$757,000 due to higher licensee unit sales, a 10% increase in the number of licensed units open and an increase in area development fee revenue. Decreases in interest income, losses on sale of assets offset by an increase in rental income accounted for the remainder of change.

Net income decreased by \$302,000 or 2%, and as a percent of total revenues declined to 4.1% compared with 5.0% the previous year. Net income per share was \$2.94, a 3% decline over the prior year net income per share of \$3.02.

Cost of food sales increased 26% in fiscal 1980. As a percentage of food revenues, cost of food sales increased to 44.4% from 42.2% primarily due to increases in meat, produce and other costs, resulting from inflation and changes in the product mix. Increases in the food cost components were partially offset by price increases and improved operating controls.

Restaurant operating expenses increased 18% but decreased as a percent of total revenues from 41.6% to 41%. The primary reasons for the absolute dollar increase were the result of higher unit labor costs, due to an increase in the minimum wage, a larger average number of units in operation and increased depreciation and maintenance costs. Also, advertising expenses increased 4% to \$11,930,000 but decreased as a percentage of revenues from 4.2% to 3.6%.

Rent expense increased by 29% as the result of the increase in the number of steakhouses. As a percentage of total revenues, rent expense increased to 2.6% as compared to 2.4% due to the application of percentage rent factors at higher unit revenues.

General and administrative expenses increased a planned 38%, representing 3.4% of total revenues, as compared with 3.0% the previous year. The increase is the result of staff additions and operational support programs in the Corporate Development, Marketing, Human Resources and Finance areas.

Interest expense and other decreased \$193,000 or 2%. The components of the change are the result of several offsetting factors and are fully described in Note B to the Consolidated Financial Statements.

Total income taxes decreased \$822,000 or 8%. The effective tax rate was 39.8% as compared to 41.4% in fiscal 1979. The decrease in total income taxes was the result of a decrease in the federal statutory tax rate of 2%, an increase in the investment tax credits, partially offset by an increase in state and local taxes.

Management's
Discussion of
Financial Condition
and Results of
Operations (Continued)

Total revenues increased by \$77,359,000 or 39% due primarily to an increase in average annual per unit sales of \$125,000 or 24%. Customer counts advanced 5%. Marketing efforts also resulted in a significant shift in customers' purchases of top-of-the-line entrees. New units, acquisitions and inflation accounted for the remainder of the revenue increase.

Service fees and other income increased \$545,000 or 11%. Licensee service fees decreased by \$429,000 during fiscal 1979 due to the acquisition of licensee-operated units. The decrease in service fees, however, was offset by an increase of \$974,000 in interest earned on short-term security investments achieved by increased funds provided from operations, a new cash management system and investment of the proceeds of \$20,000,000 private placement completed in November, 1978.

Net income increased by \$4,840,000 or 54% and net income per share was \$3.02 or 51% greater than fiscal 1978. Net income as a percent of revenues advanced to 5% compared with 4.6% in the previous year.

Cost of food sales increased 39%, but as a percentage of food revenues, decreased from 42.7% to 42.2%. The improvement was achieved by better steakhouse management controls, improved use of computer-monitored electronic cash registers and improved product mix. Increases in the cost of beef were offset by price increases, operating efficiency and improved controls. Due to volume buying and the Company-owned portion control and freezer facilities in the southern and midwest United States, meat price increases were maintained below the increases experienced at the retail level.

Restaurant operating expenses increased 40% but remained virtually unchanged as a percentage of food revenues. The primary reasons for the cost increase resulted from higher labor costs due to minimum wage increases and a higher average number of units in operation. Also, advertising expenditures increased 77% to \$11,448,000 including \$1,000,000 expended in support of the introduction of a new prime rib entree.

Rent expense increased by 22% as the result of the increase in the number of steakhouses. As a percentage of total revenues, rent expense decreased to 2.4% as compared to 2.7% due to higher unit revenues.

General and administrative expenses increased a planned 44%, representing 3% of total revenues, as compared with 2.9% the previous year.

Interest expense increased 26% as the result of a new private placement of \$20,000,000 of senior notes together with the issuance of debt in connection with acquisitions.

Total income taxes increased 45% due to the increase in income before taxes to \$23,545,000 as compared with \$15,705,000, a 50% change. The effective tax rate was 41.4% as compared to 43% in 1978 as the result of increased investment tax credits at higher capital expenditure levels.

Fiscal 1979
Compared to
Fiscal 1978

**Financial Reporting
and Code of Business Conduct**

**Financial
Reporting**

The management of Ponderosa System, Inc. has directed considerable effort toward maintaining confidence in the integrity of the financial information contained in this Report and seeing that the statements have been prepared in accordance with generally accepted accounting principles, applying certain judgments as required.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and to produce records sufficient to prepare reliable financial information. This system is regularly under the scrutiny of an internal audit group and the Company's independent auditors.

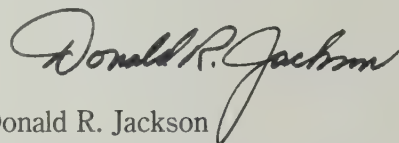
The Board of Directors, through its Audit Committee composed solely of outside directors, oversees management's responsibilities in the preparation of financial statements. The Audit Committee recommends the selection of the independent auditors, subject to Board of

Directors and stockholder ratification. To ensure complete independence, the Company's independent auditors have full and free access to meet with the Audit Committee, with or without management present.

The Audit Committee meets regularly with the independent auditors, the internal auditors, as well as Ponderosa management to review accounting, auditing, internal accounting controls and financial reporting matters.



Gerald S. Office, Jr.
Chairman of the Board and
President



Donald R. Jackson
Executive Vice President and
Chief Financial Officer

**Code of
Business
Conduct**

The Board of Directors of the Company has approved a Code of Business Conduct which has been distributed to all management employees, including steakhouse executive managers, describing the ethical and business principles that the Company requires for the conduct of its business. This Code

covers accounting and corporate records, relationships with associates, corporate and employee participation in the governmental process and codes of compliance. The Company will strive to always conduct its business within the highest standards of business conduct.

Index to the Consolidated
Financial Statements
and Notes
and Report of
Independent Accountants

Statement of Consolidated Income	22
Statement of Changes in Consolidated Financial Position	23
Consolidated Balance Sheet	24-25
Statement of Consolidated Stockholders' Equity	26
Notes to Consolidated Financial Statements	27-39

To The Board of Directors
Ponderosa System, Inc.
Dayton, Ohio

We have examined the consolidated balance sheet of Ponderosa System, Inc. and subsidiaries as of February 26, 1981, and February 28, 1980, and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended February 26, 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Ponderosa System, Inc. and subsidiaries at February 26, 1981, and February 28, 1980, and the consolidated results of their operations and the changes in their financial position for each of the three years in the period ended February 26, 1981 in conformity with generally accepted accounting principles consistently applied except for the change, with which we concur, for the year ended February 28, 1980, as to the capitalization of certain interest costs as described in Note B to the financial statements.

Ernst & Whinney

Dayton, Ohio
April 6, 1981

Report of
Independent
Accountants

PONDEROSA SYSTEM, INC.
**Statement of
Consolidated Income**

Year Ended (In thousands except per share data)	February 26, 1981	February 28, 1980 *	February 22, 1979
Revenues			
Food sales	\$ 329,551	\$ 322,744	\$ 268,522
Service fees and other income	4,497	5,679	5,385
Total Revenues	334,048	328,423	273,907
Cost and Expenses			
Cost of food sales	145,805	143,207	113,309
Restaurant operating expenses	151,270	134,787	113,849
Rent expense	11,031	8,417	6,522
General and administrative expenses	14,017	11,299	8,197
Interest expense and other – Note B	9,898	8,292	8,485
Total Cost and Expenses	332,021	306,002	250,362
Income Before Income Taxes	2,027	22,421	23,545
Income Taxes – Note C			
State and local	1,114	2,408	827
Federal			
Current	(3,522)	4,845	8,068
Deferred	1,867	1,672	852
Total Income Taxes	(541)	8,925	9,747
Net Income	\$ 2,568	\$ 13,496	\$ 13,798
Net Income Per Share	\$ 0.60	\$ 2.94	\$ 3.02
Average Shares Outstanding	4,305,000	4,589,000	4,572,000

*Comprised of 53 weeks

See notes to consolidated financial statements.

Statement of
Changes in
Consolidated
Financial Position

Year Ended (In thousands)	February 26, 1981	February 28, 1980	February 22, 1979
Funds Provided			
From Operations			
Net income	\$ 2,568	\$13,496	\$13,798
Items not requiring current outlay of working capital			
Depreciation	15,322	13,325	10,375
Amortization	1,539	1,305	1,077
Deferred federal income taxes	5,298	416	852
Funds Provided From Operations	24,727	28,542	26,102
Carrying value of property, plant and equipment disposals	8,734	6,096	3,481
Increase in long-term borrowings and capitalized lease obligations	20,306	22,531	28,176
Total Funds Provided	53,767	57,169	57,759
Funds Used			
Additions to property, plant and equipment	19,970	47,221	35,977
Reduction in long-term borrowings and capitalized lease obligations	20,664	12,224	13,478
Cash dividends	1,296	1,838	1,486
Purchase of Common Stock and non-purchase agreement	7,406	—	—
Acquired in connection with acquisitions – Note I			
Leaseholds and equipment	387	1,638	4,756
Other assets	(348)	2,828	4,628
Long-term obligations assumed	—	(427)	(2,760)
Other – net	2,172	1,021	433
Total Funds Used	51,547	66,343	57,998
Increase (Decrease) in Working Capital	\$ 2,220	\$ (9,174)	\$ (239)
Increases (Decreases) in Components of Working Capital			
Cash and short-term investments	\$ (2,610)	\$ (5,822)	\$ (441)
Accounts and notes receivable	(683)	955	1,398
Recoverable federal income taxes	3,500	1,017	—
Inventories	(4,954)	1,840	11,409
Prepaid expenses	(588)	231	951
Accounts payable	10,385	(6,536)	(13,833)
Accrued expenses	(2,713)	25	(1,771)
Federal income taxes	1,956	(519)	4,211
Current portion of long-term obligations	(2,073)	(365)	(2,163)
Increase (Decrease) in Working Capital	\$ 2,220	\$ (9,174)	\$ (239)

See notes to consolidated financial statements.

Consolidated
Balance Sheet

Assets	February 26, 1981	February 28, 1980
(In thousands)		
Current Assets		
Cash	\$ 2,835	\$ 1,445
Short-term investments	5,000	9,000
Accounts and notes receivable – Note D	2,992	3,675
Recoverable federal income taxes	4,517	1,017
Inventories	14,654	19,608
Prepaid expenses	2,065	2,653
Total Current Assets	32,063	37,398
 Property, Plant and Equipment – Notes F and G		
Land and improvements	8,971	8,914
Buildings, leaseholds and improvements	117,599	109,982
Equipment	92,216	81,881
Construction in progress	467	12,472
Total Property, Plant and Equipment	219,253	213,249
Less accumulated depreciation and amortization	(63,399)	(53,696)
Net Property, Plant and Equipment	155,854	159,553
 Other Assets – Note E	17,167	15,254
Total Assets	\$205,084	\$212,205

	February 26, 1981	February 28, 1980	Liabilities and Stockholders' Equity
Current Liabilities			
Accounts payable	\$ 22,340	\$ 32,725	
Accrued payroll and employee benefits	4,992	4,874	
Accrued interest	2,782	1,243	
Accrued expenses	3,095	2,039	
Federal income taxes	—	1,956	
Current portion of long-term obligations	6,135	4,062	
Total Current Liabilities	39,344	46,899	
Senior Notes Payable – Note F	58,428	48,811	
Obligations under Capitalized Leases – Notes F and G	33,802	43,062	
Subordinated Debentures – Note F	1,360	2,052	
Deferred Federal Income Taxes	7,370	2,072	
Stockholders' Equity – Note F			
Common Stock, par value \$0.10 per share: authorized 25,000,000 shares (issued 1981 – 4,781,634; 1980 – 4,774,335)	478	477	
Additional paid-in capital	9,984	9,919	
Retained earnings	60,305	59,033	
	70,767	69,429	
Less cost of shares in treasury (shares in 1981 – 580,139; 1980 – 170,754)	(5,987)	(120)	
Total Stockholders' Equity	64,780	69,309	
Total Liabilities and Stockholders' Equity	\$205,084	\$212,205	

See notes to consolidated financial statements.

PONDEROSA SYSTEM, INC.

Statement of
Consolidated
Stockholders'
Equity

Year Ended (In thousands)	February 26, 1981	February 28, 1980	February 22, 1979
Common Stock			
Balance at beginning of year	\$ 477	\$ 477	\$ 476
Sale of shares under stock option plan — Note H	1	—	1
Balance at End of Year	478	477	477
Additional Paid-In Capital			
Balance at beginning of year	9,919	9,641	9,500
Excess of proceeds over par value of shares issued in connection with stock options exercised — Note H	65	82	60
Excess of contribution over cost of treasury shares issued in connection with TRASOP trust — Note H	—	196	81
Balance at End of Year	9,984	9,919	9,641
Retained Earnings			
Balance at beginning of year	59,033	47,375	35,063
Net income for year	2,568	13,496	13,798
Cash dividends (per share: 1981 — \$0.30; 1980 — \$0.40; 1979 — \$0.325 and equivalent to annual rate of \$0.40 per share in 1981 and 1980 and \$0.325 per share in 1979)	(1,296)	(1,838)	(1,486)
Balance at End of Year	60,305	59,033	47,375
Less Treasury Stock			
Balance at beginning of year	(120)	(161)	(173)
Cost of shares issued in connection with contribution to TRASOP trust (shares in 1981 — 21,215; 1980 — 16,618; 1979 — 4,596) — Note H	219	41	12
Purchase of common stock	(6,086)	—	—
Balance at End of Year	(5,987)	(120)	(161)
Total Stockholders' Equity	\$64,780	\$69,309	\$57,332

See notes to consolidated financial statements.

The Company: The Company operates solely in the food service industry.

Basis of Consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions are eliminated in consolidation.

Short-term Investments: Short-term investments are stated at the lower of cost or market.

Inventories: Inventories are stated at the lower of cost or market on the first-in, first-out (FIFO) method.

Property, Plant and Equipment:

Property, plant and equipment are carried at cost and include expenditures for new facilities, costs of obtaining leaseholds, significant betterments to existing facilities, certain capitalized internal costs and capitalized leases. Maintenance, repairs and minor renewals are charged to expense as incurred.

The cost of assets retired or otherwise disposed of, together with the accumulated depreciation thereon, are relieved from the appropriate asset and accumulated depreciation accounts. Any gain or loss resulting from these transactions is reflected in income.

Depreciation and Amortization:

Depreciation and amortization are computed on the straight-line method over periods designed to amortize the cost of the assets over their estimated useful lives. The general ranges of depreciation and amortization rates are as follows:

Buildings, 2-4%; Leaseholds, 5-7%; Equipment, 8-33%; Improvements, 5-10%.

Other Assets: Other assets are comprised principally of intangible assets resulting from certain acquisitions. These costs are being amortized on a straight-line method over periods ranging from 5 to 40 years.

Income Taxes: Federal taxes are provided for all items included in the statement of income, regardless of the period when such items are reported for tax purposes. The Company follows the practice of providing deferred taxes for timing differences between financial accounting and income tax purposes. Investment tax credits are recorded as a reduction of current income tax expense in the year assets are placed in service (flow-through method).

Stock Options: Upon exercise of stock options, an amount equal to the par value of common stock (\$0.10) is credited to common stock for each share issued and the balance of the proceeds is credited to additional paid-in capital. No amounts are included in income in connection with the Plan.

Net Income Per Share: Net income per share is computed on a weighted average of shares of common stock outstanding during each year. Exercise of stock options, which are common stock equivalents, would cause no significant dilution in net income per share.

Notes to
Consolidated
Financial Statements
(Continued)

Note B
Interest Expense
and Other

The components of interest expense and other for the years ended February 26, 1981, February 28, 1980 and February 22, 1979 were as follows:

(In thousands)	1981	1980	1979
Interest on funded debt	\$7,824	\$4,098	\$1,784
Imputed interest on capitalized leases	5,381	6,772	6,701
Interest capitalized	(788)	(885)	—
Income as the result of changing capital leases to operating leases	(2,519)	(1,693)	—
Total	\$9,898	\$8,292	\$8,485

The Company entered into agreements with certain of its landlords for changes in the lease terms and conditions. These new leases granted the Company additional lease renewal options and changed certain other conditions.

The Company capitalizes interest costs as part of the cost of acquiring qualifying assets

as required by Financial Accounting Standard No. 34, Capitalization of Interest Costs. Interest is capitalized by applying the effective interest rate on borrowings to cost incurred during the development and construction period. Prior to fiscal 1980, the Company expensed interest costs as incurred.

Note C
Income Taxes

The components of the deferred income tax expense at February 26, 1981, February 28, 1980 and February 22, 1979 were as follows:

(In thousands)	1981	1980	1979
Accelerated depreciation	\$1,886	\$ 645	\$ 1,389
LIFO inventory valuation used at subsidiary	(950)	1,048	—
Capitalized leases	651	135	(732)
Other — net	280	(156)	195
Total	\$1,867	\$ 1,672	\$ 852

The differences between the actual tax expense and the tax expense at the statutory federal income tax rate of 46% for 1981 and 1980 and 48% for 1979 were as follows:

(In thousands)	1981	1980	1979
Federal income tax at statutory rate	\$ 932	\$10,313	\$11,302
Investment tax credit	(1,689)	(2,637)	(2,050)
Targeted jobs tax credit	(651)	(35)	—
State and local income tax, net of federal tax benefit	602	1,301	430
Other — net	265	(17)	65
Total	\$ (541)	\$ 8,925	\$ 9,747

Notes to
Consolidated
Financial Statements
(Continued)

The components of accounts and notes receivable at February 26, 1981 and February 28, 1980 were as follows:

Note D
Accounts and
Notes Receivable

(In thousands)	1981	1980
Accounts receivable	\$2,983	\$3,666
Notes receivable	577	80
Allowance for doubtful accounts	(568)	(71)
Total	\$2,992	\$3,675

The components of other assets at February 26, 1981 and February 28, 1980 were as follows:

Note E
Other Assets

(In thousands)	1981	1980
Repurchased license fees	\$11,067	\$11,269
Excess of cost over market value of related net assets of businesses purchased	3,253	3,240
10 year Common Stock non-purchase agreement	1,320	—
Other — net	4,657	2,701
Accumulated amortization	(3,130)	(1,956)
Total	\$17,167	\$15,254

Notes to
Consolidated
Financial Statements
(Continued)

Note F
Long-term
Obligations

Long-term obligations (excluding the portion due within one year) outstanding at February 26, 1981 and February 28, 1980 were as follows:

(In thousands)	1981	1980
Senior Notes Payable		
9 $\frac{7}{8}$ % unsecured note, due in 1995	\$18,650	\$20,000
12 $\frac{1}{2}$ % unsecured note, due in 1995	10,267	5,000
Variable interest rate unsecured notes comprised of bankers' acceptances (1980 only), revolving credit notes and acquisition notes, maturing at various dates through 1986	15,462	11,400
10 $\frac{1}{2}$ % secured note, due in 2000	8,980	9,205
Real estate mortgages and industrial revenue bonds, due in varying amounts through 2001	5,069	3,206
Total Senior Notes Payable	58,428	48,811
Capitalized Lease Obligations payable at varying monthly installments, with imputed interest rates averaging 13 $\frac{1}{2}$ %	33,802	43,062
5 $\frac{7}{8}$ % Subordinated Debentures, due in 1983	1,360	2,052
Total Long-term Obligations	\$93,590	\$93,925

On November 2, 1978, the Company entered into an agreement with two insurance companies covering \$20,000,000 in principal amount of 9 $\frac{7}{8}$ % notes, due November 1, 1995. Annual principal payments of \$1,350,000 begin on

November 1, 1981 with a final payment of \$1,100,000 due on November 1, 1995. The note agreement contains covenants as to maintenance of net worth, current ratios, limitation on Senior Funded Debt and restricts the amount of retained earnings that may be paid as dividends.

Under the most restrictive covenant, there were \$11,311,000 of unrestricted retained earnings available for the payment of dividends.

On February 26, 1980 and April 3, 1980, the Company borrowed \$5,000,000 and \$6,000,000, respectively, under an \$11,000,000 Private Placement Agreement at an interest rate of 12½%, with terms and conditions the same as the 9⅞% Agreement. Annual principal payments of \$733,333 begin on November 1, 1981.

On February 26, 1980, the Company borrowed \$9,277,000 under a 10½% senior secured note and agreement, due March 1, 2000. The note is secured by a first mortgage on the Company's new portion control and freezer facility in Bristol, Indiana and provide for semi-annual payments of \$559,000 beginning September 1, 1980. The Agreement also is secured by a lien on certain real estate and personal property necessary to operate the high-rise freezer portion of the Bristol, Indiana facility. The aggregate net book value of the portion control facility is approximately \$12,900,000 at February 26, 1981.

Real estate mortgages at interest rates ranging from 7½% to 9⅞% relate to land and buildings purchased or constructed by the Company. At February 26, 1981, land, buildings and improvements with an aggregate net book value of approximately \$4,929,000 were mortgaged under these obligations.

During fiscal 1981, the Company financed certain of its facilities with \$2,200,000 of Industrial Revenue Bonds, a portion of which is secured by land and buildings with an aggregate net book value of approximately \$1,490,000. The bonds bear interest at rates of 9% and 70% of the prime rate and require repayment at various dates through 1992.

The 5⅞% Debentures are subordinated to all outstanding or subsequently incurred senior indebtedness. The Debentures are redeemable at the option of the Company in whole or in part at redemption prices ranging from 100¾% currently to 100% beginning December 1, 1982. An annual sinking fund payment of \$715,000 is required each December 1 until the bonds are redeemed in full.

During fiscal 1979, the Company entered into a \$20,000,000 revolving credit agreement with a group of banks of which \$11,000,000 was outstanding at February 26, 1981; no amounts were outstanding at February 28, 1980. The Agreement matures on March 1, 1984. The interest rate is 115% of the prime rate. A commitment fee equal to ½ of one percent per year on the unused amount of the available commitment is charged. This fee abates pro rata when the borrowing facility is being used. This Agreement requires no compensating balances be maintained at any time.

Annual principal payments on long-term obligations required during the fiscal years after 1982 are as follows: 1983 — \$6,890,000; 1984 — \$6,885,000; 1985 — \$15,169,000 and 1986 — \$4,396,000.

At February 28, 1980, short-term debt comprised of bankers' acceptances of \$4,840,000 was classified as a senior obligation, since it was refinanced utilizing long-term debt. No bankers' acceptances were outstanding at February 26, 1981.

The Company has obtained amendments or waivers to its borrowing agreements during fiscal 1981 and expects to renew them in fiscal 1982.

Notes to
Consolidated
Financial Statements
(Continued)

Note G
Leases

The Company is a party to a number of noncancellable lease agreements primarily involving steakhouse land and buildings.

Minimum rentals relating to operating leases are expensed as incurred. Minimum rentals relating to capital leases are recorded as an asset and a long-term obligation. The recorded assets are being amortized on a straight-line method over the lease term and interest expense is accrued on the basis of the outstanding lease obligation.

Description of Leasing Agreements –
The Company's leases are noncancellable

and expire on various dates primarily before the year 2000. The majority of the lease terms are for twenty years, contain renewal options and provide for minimum rents with additional rents accruing when sales exceed specified amounts.

Capital and Operating Lease

Commitments – The following is a schedule by year of future minimum payments under capital leases together with the related obligations (present value of future minimum rentals) and rental payments required under long-term operating leases at February 26, 1981:

(In thousands)	Capital Leases	Operating Leases
1982	\$ 6,346	\$ 9,134
1983	5,962	9,117
1984	5,735	9,043
1985	5,664	8,960
1986	5,523	8,898
1987 and thereafter	49,501	73,920
Total minimum lease payments	78,731	\$119,072
Less amounts representing imputed interest	(43,163)	
Total obligations	35,568	
Less current portion	(1,766)	
Obligations Under Capitalized Leases	\$33,802	

Amortization expense for property under capital leases was \$2,401,000, \$2,954,000 and \$2,834,000 in fiscal 1981, 1980 and 1979, respectively.

Rent expense for all operating leases consisted of:

(In thousands)	1981	1980	1979
Minimum rents	\$ 9,011	\$ 6,256	\$ 5,357
Contingent rents	980	838	402
Other leases	1,040	1,323	763
Total rent expense	11,031	8,417	6,522
Less sublease rent income	(1,875)	(1,106)	(989)
Net rent expense	\$ 9,156	\$ 7,311	\$ 5,533

Note G
Leases
(Continued)

Annual minimum sublease rent income under noncancellable subleases for the years after 1981 are as follows: 1982—\$1,737,000; 1983—\$1,737,000; 1984—\$1,723,000; 1985—\$1,702,000; 1986—\$1,701,000; 1987 and thereafter—\$14,068,000.

Included in property, plant and equipment are the following capital leases:

(In thousands)	1981	1980
Buildings	\$40,178	\$50,017
Equipment	1,221	1,122
Accumulated amortization	(13,085)	(14,894)
Net leased property	\$28,314	\$36,245

Notes to
Consolidated
Financial Statements
(Continued)

Note H
Employee
Benefit Plans

The Company has non-contributory pension plans covering employees who have attained age 25 and completed one year of service. The Company's policy is to fund pension expense currently including amortization of prior service cost over a period of thirty years. Total pension

expense for the years ended February 26, 1981, February 28, 1980 and February 22, 1979 was \$330,000, \$260,000, and \$217,000, respectively. A comparison of the accumulated plan benefits and plan net assets for the defined benefit plan of the Company, as of January 1, 1980 and 1979 (latest valuation date) is shown below:

(In thousands)	1980	1979
Actuarial present value of accumulated plan benefits:		
Vested	\$138	\$ 15
Nonvested	442	405
	\$580	\$420
Net assets available for benefits	\$674	\$423

The assumed annual rate of return used in determining the actuarial present value of accumulated plan benefits is 7%.

The Company also has a Tax Reduction Act Stock Ownership Plan ("plan") which was adopted in fiscal 1978. The annual contribution to the plan is in an amount equal to the additional 1% federal investment tax credit allowed during each

fiscal year. The total amount contributed to the plan in common stock was \$219,000 in 1981, \$237,000 in 1980, and \$93,000 in 1979.

The Company adopted a qualified stock option plan on June 16, 1972 and reserved 200,000 shares of common stock for issue under the plan. Under the plan, key employees may be granted options, at the discretion of the Executive Compensation

Committee of the Board of Directors, at prices not less than 100% of the fair market value at the date of grant. Each option outstanding is presently exercisable pursuant to action of the Board of Directors that accelerated the exercise rights with respect to options heretofore granted or which may be granted under the plan. No option is exercisable while any option previously granted to the same

individual at a greater exercise price is outstanding. All options terminate not later than five years from the date of grant and must be exercised, with certain exceptions, while the holder is in the employ of the Company.

The following summarizes the options for the years ended February 26, 1981 and February 28, 1980:

Note H
Employee
Benefit Plans
(Continued)

	Number of Shares	Option Price Per Share
February 26, 1981:		
Options outstanding and exercisable	117,700	\$7.8125 to \$28.3750
Options exercised	7,299	\$6.1250 to \$10.1250
February 28, 1980:		
Options outstanding and exercisable	169,499	\$6.1250 to \$28.3750
Options exercised	6,842	\$6.1250 to \$13.6250

Notes to
Consolidated
Financial Statements
(Continued)

Note I
Acquisitions

On April 20, 1979, the Company acquired all of the assets of seven steakhouses owned by Roschman Restaurant Administration, Inc. ("Administration"). The purchase price was \$2,000,000 of which \$580,000 was paid in cash at the time of closing, and the balance of \$1,420,000 was represented by unsecured notes.

On December 7, 1979, the Company acquired all of the assets of nine steakhouses operated by the former Ponderosa of Greater Detroit, Inc. ("Detroit") for a total purchase price of \$1,322,500. Of the total purchase price, \$812,500 was paid in cash at the time of closing, and the balance of \$510,000 was represented by unsecured notes of which \$410,000 was paid in full on December 1, 1980 and the remainder was set-off against the purchase price under the acquisition agreement.

On September 1, 1978, the Company acquired all of the outstanding shares of capital stock of St. Louis Metropolitan Ponderosa, Inc. ("St. Louis"), which operated 18 Ponderosa Steakhouses, for a total purchase price of \$6,000,000 of which

\$1,600,000 was paid in cash at the time of closing and the balance of \$4,400,000 was represented by unsecured notes.

On December 15, 1978, the Company acquired all of the outstanding shares of capital stock of Florida Food Enterprises, Inc. ("Florida"), which operated one Ponderosa Steakhouse, for a total purchase price of \$150,000 of which \$40,000 was paid in cash at the time of closing and the balance of \$110,000 was represented by unsecured notes.

In connection with certain of the above acquisitions, the Company entered into separate non-competition agreements which require total annual payments ranging from \$129,000 in fiscal 1982 to \$79,000 in fiscal 1985.

The results of operations of the acquired companies are included in the statement of consolidated income from the date of purchase.

The following table summarizes, on an unaudited pro forma basis, the consolidated results of the Company as though Administration, Detroit, St. Louis and Florida had been acquired at the beginning of fiscal 1979:

(In thousands except per share data)	1980	1979
Total Revenues	\$333,393	\$290,816
Net Income	\$ 13,547	\$ 14,241
Net Income Per Share	\$ 2.95	\$ 3.11

Note J
Summary of
Quarterly
Results of
Operations
(Unaudited)

A summary of the unaudited interim quarterly results of operations is included on page 14 of the annual report.

Financial statements presented in accordance with generally accepted accounting principles have been traditionally prepared based on historical costs and dollars of varying purchasing power. Accordingly, such traditionally prepared financial statements do not adequately measure the effects of inflation on financial results. In recognition of the need to provide readers of financial statements with information to assist them in assessing that impact, the Financial Accounting Standards Board (FASB) in September, 1979 issued Standard No. 33, Financial Reporting and Changing Prices, which requires the disclosure of certain information on the effects of inflation on business enterprises.

It should be emphasized that the following information is viewed as experimental in nature by the FASB. It involves the use of assumptions and estimates, and therefore should be viewed in that context and not necessarily as a reliable indicator of the effect of inflation on the Company's results of operations or its financial position.

The table presented on page 38 presents certain financial information restating historical costs in terms of constant dollars and current costs. Under the constant dollar method, historical costs are adjusted for changes that have occurred in the general purchasing power of the dollar, in terms of average fiscal 1981 dollars, as measured by the Consumer Price Index. Under the current cost method, historical costs are restated to costs which are current at the balance sheet date or date of sale or use generally by reference to current prices and by application of specific price indices to historical costs.

Estimates of asset life and related salvage value for the Company's property, plant and equipment and the method of depreciation and amortization (straight-line) are used consistently in the historical financial statements and the constant dollar and current cost presentations. As prescribed by FAS 33, no adjustments or allocations of the amount of income taxes reported in the historical financial statements have been made in determining net income adjusted for the effects of changing prices.

The five-year summary, presented on page 39, reflects the adjustments to the fiscal 1981 data described above and similar adjustments for fiscal 1980. In addition, revenues and certain per share data for fiscal 1977 to 1979 have been restated to average fiscal 1981 dollars based upon the Consumer Price Index. Other data for prior years are not required by FAS 33 to be restated.

Note K
Information on
Effects of
Changing Prices
(Unaudited)

Notes to
Consolidated
Financial Statements
(Continued)

Note K (Continued)	For Year Ended February 26, 1981			
	(In thousands except per share data)	As Reported	Constant Dollar	Current Cost
Summary of Consolidated Income Adjusted for Changing Prices (Unaudited)	Income Before Income Taxes	\$ 2,027	\$ 2,027	\$ 2,027
	Adjustments to restate cost and expenses for the effects of changing prices:			
	Cost of food sales	—	(1,899)	141
	Depreciation and amortization	—	(7,397)	(6,952)
	Income (Loss) Before Income Taxes	2,027	(7,269)	(4,784)
	Income Taxes	(541)	(541)	(541)
	Net Income (Loss)	\$ 2,568	\$ (6,728)	\$ (4,243)
	Net Income (Loss) Per Share	\$ 0.60	\$ (1.56)	\$ (0.99)
	Increase in general price level of inventories, fixed assets and other assets held during the year			\$75,651
	Increase in current cost of inventories, fixed assets and other assets held during the year*			61,212
	Excess of increase in general prices over increase in current costs			\$14,439

*At February 26, 1981, the current cost of inventories, net fixed assets and other assets were \$14,654,000, \$219,204,000 and \$24,680,000 respectively.

Five-Year Summary
of Selected Financial Data
Adjusted for the Effects
of Changing Prices
(Unaudited)

(In thousands except per share data)	Fiscal Year				
	1981	1980	1979	1978	1977
Total Revenues					
As Reported	\$334,048	\$328,423	\$273,907	\$196,548	\$163,494
Constant Dollar	\$334,048	\$371,267	\$346,939	\$269,169	\$238,872
Net Income (Loss)					
As Reported	\$ 2,568	\$ 13,496	—	—	—
Constant Dollar	\$ (6,728)	\$ 7,086	—	—	—
Current Cost	\$ (4,243)	\$ 8,283	—	—	—
Net Income (Loss) Per Share					
As Reported	\$ 0.60	\$ 2.94	—	—	—
Constant Dollar	\$ (1.56)	\$ 1.54	—	—	—
Current Cost	\$ (0.99)	\$ 1.80	—	—	—
Dividends Declared Per Share					
As Reported	\$ 0.40*	\$ 0.400	\$ 0.325	\$ 0.075	—
Constant Dollar	\$ 0.40*	\$ 0.452	\$ 0.412	\$ 0.100	—
Market Price Per Share at Year-End					
As Reported	\$ 12.000	\$ 11.125	\$ 17.750	\$ 15.625	\$ 6.000
Constant Dollar	\$ 11.457	\$ 11.826	\$ 21.538	\$ 20.842	\$ 8.514
Stockholders' Equity at Year-End					
As Reported	\$ 64,780	\$ 69,309	—	—	—
Constant Dollar	\$140,431	\$142,564	—	—	—
Current Cost	\$129,758	\$134,551	—	—	—
Purchasing Power Gain on Net Monetary Liabilities	\$ 13,412	\$ 16,936	—	—	—
Excess of Increase in General Prices Over Increase in Current Costs	\$ 14,439	\$ 14,177	—	—	—
Average Consumer Price Index	251.3	222.3	198.4	183.5	172.0

*Includes fourth quarter dividend declared after the end of fiscal 1981.

Locations

The Ponderosa
System

Ponderosa Steakhouses are located throughout North America.
Planned overseas expansion will make the Ponderosa name familiar worldwide.

United States

	Company	Licensed	Total
Arizona	—	3	3
Connecticut	8	—	8
Florida	21	4	25
Georgia	7	—	7
Illinois	49	8	57
Indiana	22	25	47
Iowa	7	—	7
Kansas	4	—	4
Kentucky	9	7	16
Maryland	—	32	32
Massachusetts	8	—	8
Michigan	30	20	50
Minnesota	9	—	9
Missouri	19	—	19
Nebraska	3	—	3
New Jersey	9	3	12
New York	52	2	54
North Dakota	—	2	2
Ohio	102	6	108
Pennsylvania	52	1	53
Rhode Island	4	—	4
Tennessee	1	—	1
Texas	—	2	2
Utah	—	1	1
Virginia	7	6	13
Washington	—	1	1
West Virginia	8	—	8
Wisconsin	31	2	33
Wyoming	—	1	1
TOTAL UNITED STATES	462	126	588

Canada

Alberta	—	10	10
Manitoba	—	5	5
New Brunswick	—	3	3
Newfoundland	—	1	1
Nova Scotia	—	4	4
Ontario	—	62	62
Prince Edward Island	—	1	1
Quebec	—	20	20
Saskatchewan	—	4	4
TOTAL CANADA	—	110	110
TOTAL SYSTEM	462	236	698

Form 10-K Information The Company will furnish to any shareholder without charge a copy of the Company's annual report filed with the Securities and Exchange Commission on Form 10-K for 1981 (including the financial statements and schedules thereto) upon written request from the shareholder addressed to Vice President and Treasurer, Ponderosa System, Inc., P.O. Box 578, Dayton, Ohio 45401.

Financial Information Anyone seeking financial information other than Form 10-K information is requested to write to Chief Financial Officer, Ponderosa System, Inc., P.O. Box 578, Dayton, Ohio 45401.

Equal Employment Opportunity

Statement The Company continues its commitment to Equal Employment Opportunity in all of its policies regarding recruitment, hiring, transfers, promotions, compensation, benefits, and training.

Statement of Organization Philosophy Ponderosa System, Inc. has published its overall objectives and business plans in booklet form: Statement of Organization Philosophy. The statement will be of interest to shareholders and others who wish to better understand the principles and philosophies surrounding the Company. If you would like a copy, please write to Chief Financial Officer, Ponderosa System, Inc., P.O. Box 578, Dayton, Ohio 45401.

Annual Meeting The Annual Meeting of Shareholders will be held at the Dayton Airport Inn, Entrance Road, James M. Cox Dayton International Airport, Dayton, Ohio, at 9:00 AM on Monday, June 22, 1981.

Auditors Ernst & Whinney, Dayton, Ohio

Legal Counsel Coolidge, Wall, Matusoff, Womsley & Lombard Co., L.P.A., Dayton, Ohio

Registrars Winters National Bank and Trust Co., Dayton, Ohio; Chemical Bank, New York, New York

Transfer Agents Winters National Bank and Trust Co., Dayton, Ohio; Chemical Bank, New York, New York

Trustee The Bank of New York, New York, New York

Corporate Headquarters Ponderosa System, Inc., P.O. Box 578, Dayton, Ohio 45401; Telephone (513) 890-6400

This annual report is published solely to supply information about the Company to present shareholders to whom the report is addressed. It is not a part of the proxy soliciting material being sent to the shareholders and is not to be used as such. Also, the Report, unless otherwise indicated, is not intended as a representation, prospectus or circular with respect to any securities and is not transmitted in connection with any sale, offer to sell or negotiation for sale, or to induce the purchase of any security of Ponderosa System, Inc.

DIRECTORS

Richard G. Brierley*†

Chairman of the Board of Directors, Sheldahl, Inc. (Manufacturer of flexible circuits), Northfield, Minnesota

Gerald S. Office, Jr.

Chairman of the Board of Directors and President, Ponderosa System, Inc.

John L. Schaefer*

Chairman of the Board and President, The Specialty Papers Co. (Manufacturer of flexible packaging materials), Dayton, Ohio

John F. Torley†

Chairman of the Executive Committee, Dayton Malleable Inc. (Manufacturer of metal castings), Dayton, Ohio

Fred G. Wall*

President and Chief Executive Officer, Robbins & Myers, Inc. (Fluids handling equipment; electric motors and controls; comfort conditioning products; and materials handling systems), Dayton, Ohio

W. H. (Bill) Williams†

Retired; Former Vice President — Materials Management, Eaton Corporation (Manufacturer of engineered products for capital goods, automotive, truck and consumer markets), Cleveland, Ohio

*Member of Audit Committee

†Member of Executive Compensation Committee

OFFICERS

Gerald S. Office, Jr.

Chairman of the Board of Directors and President

John W. Cleveland

Executive Vice President (Administration)

Philip J. Dambach

Executive Vice President (International Development)

Donald R. Jackson

Executive Vice President (Finance)

C. S. Lewis

Executive Vice President (North America Steakhouse Operations)

Michael K. Pulliam

President-ESI Meats, Inc.

John F. Barteau

Vice President (Unit Development and Purchasing)

William E. Eskew

Vice President (Operations)

R. William Flock

Vice President (Human Resources)

Donald G. Gilbert

Vice President (Operations)

Robert J. Hoffman

Vice President (Operations)

William R. Menzel

Vice President (Corporate Planning and Development)

James W. Osborn

Vice President (Operations)

Robert F. Puccio

Vice President (Licensing)

Martin M. Starr

Vice President and Treasurer

Charles R. Trego, Jr.

Vice President and Controller

John R. Mohr

Secretary and Corporate Real Estate Counsel

